In the United States Bankruptcy Court
for the
Southern District of Georgia
Savannah Division

In the matter of:	)	
	)	Chapter 7 Case
E. L. MOBLEY, INC.	)	
	)	Number 87-41149
Debtor	)	

MEMORANDUM AND ORDER ON TRUSTEE'S OBJECTION TO CLAIM OF THE INTERNAL REVENUE SERVICE

This matter comes before the Court on the Chapter 7 Trustee's objection to claim number 17, filed by the Internal Revenue Service ("IRS") in Debtor's Chapter 7 case. Based upon the parties' briefs, the record in the file and applicable authorities, I make the following Findings of Fact and Conclusions of Law.

FINDINGS OF FACT

Debtor's case was initiated as an involuntary Chapter 7 proceeding December 2, 1987. Debtor had previously been in a Chapter 11 proceeding which resulted in a confirmed Chapter 11 plan.

Trustee's administration of Debtor's estate has been delayed due to the fact that many of the Debtor's business records were seized by the United States Customs Service in its criminal investigation of Debtor and its principal, Mr. E.L. Mobley ("Mobley"). Said records were held for a lengthy period of time prior to being turned over to the Trustee. According to the record in this case, the Trustee sought approval on September 1, 1992, for payment of the sum of $1,935.91 to Lucas Moving and Storage which corresponded roughly with the date the Debtor's voluminous files and business records were turned over to the Trustee, having previously been held in storage at the behest of the Customs Service.

As the case was administered, the Trustee filed an adversary proceeding against one Claude P. Brown and First Union International Transportation Services, Inc., seeking to set aside allegedly preferential transfers by the Debtor to Brown in the amount of $181,342.49. On August 16, 1990, this Court issued a notice of the Trustee's Application to Approve a Compromise and Settlement of that adversary which recited that "Trustee . . . will acknowledge a right of set off by Brown against the above-stated sum in the amount of $48,513.48 for funds advanced by Brown for the benefit of the estate and for present consideration leaving a balance due the estate from Brown of $132,829.01." The notice issued by the Court established September 5, 1990, as the deadline for any creditor or party in interest to object in writing to the terms of the settlement and scheduled a hearing for September 20, 1990, at 11:00 a.m., to consider approval of the application. The matter was heard pursuant to notice, and by order dated September 22, 1990, and filed September 24,

1990, this Court approved the compromise and settlement along the terms outlined in the notice. The terms of the settlement permitted Mr. Brown to retire his indebtedness to the estate at a rate of $1,000.00 per month for six months increasing thereafter to $3,000.00 per month until the entire principal amount, together with interest, was paid in full.

The set off which the Trustee agreed Mr. Brown was entitled to assert as against the voidable preference action was evidenced by three checks, all dated September 10, 1987, payable on Mr. Brown's investment account at The Citizens and Southern National Bank in the aggregate amount of $48,513.48. Those checks were attached to the Trustee's objection as Exhibit "C-3(a)" and were payable respectively to the Internal Revenue Service in the amount of $26,823.22 (Check # 3171), the Georgia Department of Revenue in the amount of $3,082.00 (Check # 3172) and the Georgia Ports Authority in the amount of $18,608.26 (Check # 3177). Those checks represented the proceeds of a loan made by Mr. Brown to E. L. Mobley, Inc., evidenced by a Demand Promissory Note dated September 10, 1987, attached to the Trustee's Objection as Exhibit "C-4."

Check number 3171, payable to the Internal Revenue Service in the amount of $26,823.22, bore the notation "to be applied to A/C 58-1094374 **only as shown above to tax bal only**." *See* Exhibit C-3(a). A/C 58-1094374 was the federal tax account number for Debtor. On the upper lefthand margin of the check, the following notations appeared indicating the type of tax liability, the quarter and year from which they originated and the

amounts to be applied from the proceeds of the check to each obligation:

941 1Q '83	$7,053.26
941 2Q '83	$7,484.18
941 3Q '83	$3,460.54
941 4Q '83	$996.84
940 1983	$3.76
941 1Q '84	$7,600.44
941 4Q '84	$115.00
940 1985	$109.20

See Exhibit C-3(a).

The evidence is uncontradicted that James H. Sams, Jr., a revenue officer with the Internal Revenue Service, was charged with the responsibility of collecting certain accounts on which Mobley, or the Debtor, was obligated. He testified that he was responsible for collecting an obligation of Mobley which represented Mobley's so-called one hundred percent penalty arising as a result of his being a responsible officer when E. L. Mobley, Inc. failed to remit trust-fund taxes to the Internal Revenue Service. Sams was also attempting to collect obligations owed by First City Group, Ltd., which he understood was a holding company which owned a number of Mobley-related corporations including Advance Transport, Savannah Fast Freight, and Debtor. Sams was also aware that Mobley's individual taxes were in a delinquent status but they had not been assigned to him for collection.

On or about September 17, 1987, Mobley paid a visit to Mr. Sams in his office and hand delivered a letter dated September 16, 1987, on the letterhead of Debtor, reciting that he was delivering check number 3171 in the amount of $26,823.22 in payment of all outstanding taxes due on account of Debtor. *See* Exhibit C-2. The letter listed types of taxes, periods and amounts for which Mobley was seeking credit by virtue of delivery of the check. Mobley requested that Sams sign an acknowledgment that he had received the letter, but Sams refused because the check was not attached or tendered to him. Sams testified that he was unwilling to sign the letter unless the check was actually received, but would have done so had Mobley ever handed him the check. A discussion ensued thereafter in which Sams advised Mobley that the $26,000.00 payment would be insufficient to satisfy Mobley's personal one hundred percent liability as a responsible officer of Debtor because the sum outstanding, including penalties and interest, was approximately $45,000.00. When Mobley learned this he apparently decided that he would not deliver the check to the Service and Sams' testimony was uncontradicted that he did not receive or see check number 3171 during that meeting.

On September 25, 1987, Mobley brought his Certified Public Accountant, William Meehan, to meet with Sams to discuss the status of his and Debtor's outstanding federal taxes. At the meeting, Sams explained to the two of them why the $26,000.00 sum would not be sufficient to retire the obligation. Apparently there had been a misunderstanding on the part of Mr. Mobley as to whether certain interest and

penalties that accrued on the obligation would be abated if the principal amount of the tax were paid. In any event, Sams requested and received copies of letters from the Bankruptcy Unit of the Internal Revenue Service outlining certain outstanding obligations of Debtor (C-1) and the September 16 letter of Debtor to Sams (C-2).

Sams had no further contact with Mobley, or anyone on behalf of Debtor, until November 17, 1987, when Mobley again appeared in his office, this time to file personal tax returns for himself and his wife for the tax years 1984 and 1985. These returns showed balances due for the two years in excess of $11,000.00. At that time, Mobley delivered to Sams a Citizens and Southern National Bank official bank check, number 10906503, payable to the Internal Revenue Service in the amount of $26,823.22 bearing the legend purchaser "C.P. Brown" (Exhibit C-5). The endorsement on Mr. Brown's original check dated September 10 (Exhibit C-3A) reads "used to purchase fed check #10906503". It was stipulated that such an endorsement is a standard banking measure for tracing funds used to purchase a bank check. The Citizens and Southern National Bank check, payable to the Service in the amount of $26,823.22, was delivered to Sams, negotiated by the Internal Revenue Service, cleared the bank, and the Service received value for it. Thus, Mobley had taken check 3171 to Citizens and Southern Bank and exchanged for a bank check made payable to the same payee, the IRS, in the same amount. The bank check did not, however, bear the notations, as set forth above, specifying the tax obligations that the check was intended to satisfy.

Mr. Sams testified that he applied the funds to the personal tax obligations of Richard and Donna Mobley for tax years 1984 and 1985 that were evidenced by the returns filed on November 17, 1987. This left slightly over $15,000.00 in unallocated funds and Mr. Sams thereafter applied the balance of the check to the first quarter 1987 and fourth quarter 1986 withholding tax obligations of First City Group, Ltd., the Mobley-created holding company.

Thus, notwithstanding the fact that the September 16 letter and notation on check number 3171 of C. P. Brown required allocation of the $26,000.00 to the obligations of Debtor, Sams applied the monies differently because the official bank check contained no such limitation. In addition, when Mobley and Sams discussed the allocation of these funds, Mobley, whom Sams had alerted to the fact that a different allocation would better serve Mobley's own interests at their initial meeting, told Sams that he could "apply the funds as he saw fit." Sams further testified that, at the time that Mobley tendered the bank check, he did not realize that the amount shown on the bank check and the one previously tendered were identical. He also testified that the notation that the purchaser of the official bank check was C. P. Brown did not alert him to the fact that the funds might be coming from the same source. Nevertheless, he had in his files a copy of Exhibits C-1 and C-2 in which the amount of the tax being remitted and the requested allocation by Debtor had been set forth in writing. Sams expressed a high degree of suspicion over Mr. Mobley's actions, having dealt with him for a considerable period of time in attempting to collect the

obligations owed the United States, but apparently did not believe that the source of the funds was any concern of the Service. Nevertheless Sams was aware that Mobley had a dual role as an individual taxpayer and as a corporate officer of a number of corporations whose tax obligations to the United States were delinquent, based on his prior dealings with Mobley.

After the check (Exhibit C-5) was forwarded for credit, Sams did discover that the amount was identical to the amount on the earlier check that had been referred to in the September 16 letter. Sams stated that he applied the funds to the individual tax obligation of Mr. and Mrs. Mobley because the funds were handed to him contemporaneously with the Mobleys filing "balance due" returns for the years 1984 and 1985. In applying the funds in this manner rather than to Debtor's obligations, he also knew that he would not be obligated to open a separate collection account. Sams testified that he applied the balance of the check to obligations of First City Group, Ltd., even though no assessment had been levied against Mobley as responsible officer for the one hundred percent penalty.

Based on this state of facts, the Trustee challenges the manner in which the funds were applied on a number of theories, as follows:

1) Sams' allocation of the $26,823.22 was inappropriate given the

fact that Sams was aware that the identical amount had been designated for payment of Debtor's tax obligations, and, in fact, at the time of the application of those funds, Sams had possession of copies of the check for which the one received in November was replacement and the September 16, 1987, letter which set forth the specific tax obligation, period and amounts to which those funds should be allocated. In other words, despite the fact that there was no designation on the check which was ultimately delivered, the Trustee contends that Sams was bound by the previous designation which had been part of his discussions with Mr. Mobley and which were evidenced in his file.

2) The Service's allocation, with the acquiescence of Mobley, of these funds to the personal obligations of Mobley and to the obligations of First City Group, Ltd., when the funds were property of Debtor's estate constituted a fraudulent transfer within the meaning of 11 U.S.C. Section 548. Accordingly, Trustee may assert the existence of that fraudulent transfer as a set off against the proof of claim of the Internal Revenue Service notwithstanding the fact that the statute of limitations for bringing Section 548 actions has expired.

3) The transfer is subject to attack under applicable state law as

found in the Uniform Commercial Code in that the United States does not stand in the posture of the holder in due course and that the transfer is subject to rescission under O.C.G.A. 11-3-207.

The Trustee also asserts entitlement to a set off of certain of the tax obligations. Exhibit C-10 sets forth the Trustee's contentions as to those which are secured, priority, unsecured or subordinated. The United States does not concede the accuracy of Trustee's spreadsheet analysis, but in the absence of any proof to the contrary and based upon the reasons that follow, I find that it accurately reflects Debtor's tax obligations. First, included in the obligations which are claimed in the Service's proof of claim, are 941 taxes for the second quarter of 1981 in the amount of $2,183.72 even though Exhibit C-7 shows that on September 30, 1981, the Service sent Debtor a bill which showed for the previous quarter, that is the second quarter of 1981, an overpayment of Debtor's 941 tax obligation. Similarly, for the fourth quarter of 1981 the Service claims a total of $5,127.90 in tax, penalty and interest for section 941 obligations when Exhibit C-8 reveals that on December 31, 1981, the Service sent Debtor a statement showing an overpayment of tax deposits for that period of nearly $2,000.00.

Mr. Sams attempted to explain these discrepancies in his testimony. He testified that although those statements were in fact rendered by the Service, there had been correcting entries in February of 1984 whereby monies previously credited to Debtor were

debited, and the credit was transferred to Savannah Fast Freight resulting in the net tax liabilities claimed by the Service in its proof of claim. Sams testimony was to the effect that ordinarily such a reverse transaction occurs at the request of the taxpayer who discovers that monies have been remitted with an improper form or account number or have otherwise been credited to the wrong account. While this may be a fairly common occurrence, Mr. Sams did not participate in the reversal of the previous credit that was given to Debtor nor in crediting it to one of Mobley's other closely held corporations and therefore is unable to testify by firsthand knowledge whether the transfer of the credit was made at the request of Debtor, Mobley, or Savannah Fast Freight. Moreover, Sams had no indication on the business records in his custody at the time of the hearing of the reason for the reversal and reallocation of these credits.

The Internal Revenue Service contends that it acted in good faith in receiving payments and applying them to various non-debtor taxpayer accounts, and that it would work an injustice at this late date if the Court rules that payments, as previously applied by the IRS, must be re-credited to the Debtor's tax liabilities. The IRS also contends that it would have great difficulty, if not otherwise be statutorily barred, from asserting a right of recovery against the taxpayers who have benefitted from the applications previously made.

CONCLUSIONS OF LAW

The Internal Revenue Service acknowledges that it received a cashier's check from Richard E. Mobley on November 17, 1987, in the amount of $26,823.22 (Exhibit "C-5"). Thus, the primary issue before the Court is whether or not the IRS was authorized, under all of the surrounding circumstances, to apply the proceeds of said check to personal tax liabilities of Mobley and his wife, and the balance to corporate tax obligations of First City Group, Limited, a corporation of which Mobley was an officer. Because I agree with the Trustee that the IRS' application of the proceeds to Mobley's personal tax obligations constitutes a fraudulent transfer under section 548 of the Bankruptcy Code that is recoverable from the IRS, it is unnecessary to address Trustee's alternative theories of recovery.

Fraudulent Transfer

A threshold question under section 548 is whether or not Trustee's use of section 548 as a defense or offset to the IRS' claim is time-barred. An action or proceeding under 11 U.S.C. Section 548 may not be commenced after two (2) years from the appointment of the Trustee under 11 U.S.C. Section 702. *See* 11 U.S.C. §546(a). It is conceded that the Trustee did not bring or fraudulent transfer action within the two (2) year limitation set forth in 11 U.S.C. Section 546. However, the Trustee asserts that 11 U.S.C. Section 546 prescribes a two-year limit only with regard to proceedings initiated by the Trustee, and Trustee asserts that Section 546 does not bar defensive reliance on the Trustee's

avoidance powers beyond the two-year limit. The Court agrees with Trustee's contention that the two-year limitation set forth in 11 U.S.C. Section 546 for the commencement of avoidance actions does not bar defensive reliance on the Trustee's avoidance powers pursuant to an objection to claim based upon 11 U.S.C. § 502(d). "§ 546(a) is limited to proceeding initiated by a trustee; the section does not bar defensive reliance on the trustee's avoiding powers outside the two-year time limit. Thus, even if the Trustee's objection was not timely under § 546(a), he could still raise the issue arguing that the claim must be disallowed pursuant to 11 U.S.C. § 502(d)." In re Octagon Roofing, 156 B.R. 214, 219 (Bankr. N.D.Ill. 1993) (*quoting in part* In re Coan, 96 B.R. 828, 831 (Bankr. N.D.Ill. 1989)). *See also* In re Stoecker, 143 B.R. 118, 127-28 (Bankr. N.D.Ill. 1992), *aff'd in part and reversed on other grounds*, 143 B.R. 879 (N.D. Ill. 1992).

One of the Trustee's duties is to examine proofs of claim and object to the allowance of any claim that is improper if a purpose would be served. 11 U.S.C. §704(5). Bankruptcy Rule 3007 requires that an objection to the allowability of a claim be in writing and a copy thereof mailed to the claimant. Bankruptcy Rule 9014 prescribes the procedures for contested matters not otherwise provided for in the Rules. An objection to claim is a contested matter within the meaning of Bankruptcy Rule 9014. Bankruptcy Rule 3007 does not set forth a time period within which the Trustee must object to the allowance of a claim. A cut-off date would be inappropriate in many instances, for it is not generally known until well into the administration of a case whether any purpose would be served by reviewing

and objecting to claims, based upon a determination that there will be a fund available for distribution of a dividend.

The filing of a proof of claim itself, from a procedural standpoint, is tantamount to the filing of a complaint in a civil action. *See* Nortex Trading Corp. v. Newfield, 311 F.2d 163, 164 (2nd Cir. 1962). The Trustee's formal objection to the claim is considered to be the answer to the claim if one treats the claim as a complaint. *See* L. King, 3 *Collier on Bankruptcy*, ¶ 502.01[03] (15th ed. 1991). Because the Trustee is not seeking an affirmative judgment and recovery from the IRS, but, rather, is seeking to assert affirmative defenses, including the defense of fraudulent transfer, the two-year limitation contained in Section 546 is inapplicable, and the Trustee's objections to claim 17 are, therefore, not time-barred.

Section 548 of the Code provides in pertinent part:

> (a) The trustee may avoid any transfer of an interest of the debtor in property . . . that was made . . . within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily--
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> > (1) made such transfer . . . with actual intent to hinder, delay or defraud any entity to which the debtor was or became, on or after the date that such transfer was made . . . indebted; or
> >
> > (2) (A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

> (B) (i) was insolvent on the date that such transfer was made . . . or became insolvent as a result of such transfer . . .

11 U.S.C. §548(a) (emphasis added).

The Court finds that the $26,823.22 payment received by the IRS on November 17, 1987, was, in fact, property of Debtor, which had been borrowed by Debtor, through its president, Mobley, in order to pay specific tax obligations owed by Debtor to the IRS. The Chapter 7 involuntary petition was filed against Debtor in this case on December 2, 1987, and the Order for relief was entered thereon on December 29, 1987. Brown's check, and the loan transaction out of which it arose, occurred on September 10, 1987, and the IRS admitted receiving the cashier's check, which had been exchanged for Brown's check, on November 17, 1987. Accordingly, the cashier's check proceeds, which were property of the Debtor, were transferred within one year before the date of the filing of the petition, either voluntarily or involuntarily, by Richard E. Mobley, then president of Debtor.

Under subsection (a)(1) of section 548, the Trustee must prove that the transfer was made "with actual intent to hinder, delay or defraud" an entity to which the debtor was indebted. It is evident from the exhibits that Debtor borrowed the money from Brown for the specific purpose of paying identified tax obligations of Debtor. Exhibit "C-2" is signed by Mobley, as president of the Debtor, and he knew the purpose for which the loan

from Brown was made. Brown was a guarantor of the corporate obligations of the Debtor and, upon payment of his guaranty obligation to First Bank of Savannah, took an assignment of the bank's notes and collateral due from Debtor. *See* Exhibit "C-6(a)" at page 5. Brown was allowed to and, in fact, did file a proof of claim in the Chapter 7 case for the amount of the First Bank of Savannah assigned obligations in the principal sum of $180,000.00. Mr. Brown was, therefore, both before and after this transfer, a creditor within the meaning of 11 U.S.C. Section 548(a)(1). Misapplication of the $26,823.22 loan proceeds to non-debtor liabilities would necessarily result in an increase in governmental tax liabilities entitled to participate in a dividend, with priority over Brown's unsecured indebtedness, which misapplication would hinder and delay Mr. Brown, who was, at all times material hereto, a creditor of the Debtor. Thus, there is no plausible explanation for Debtor's (i.e., Mobley as its president) intent in misapplying the funds other than an actual intent to harm Mr. Brown. Accordingly, I find that the Trustee has established an actual intent on the part of Debtor under 11 U.S.C. Section 548(a)(1).

Furthermore, I find that the Debtor received less than a reasonably equivalent value in exchange for the transfer of these funds. Debtor in fact received no value for the transfer. The payment of individual tax obligations of Mobley and corporate obligations of a non-debtor company resulted in no benefit to Debtor. Based upon the amount of the allowed claims in this case, and the Trustee's representations as to the available fund for payment of a dividend, the Debtor was insolvent at the time of the

transfer, or became insolvent as a result thereof. The IRS offered no evidence to rebut the Trustee' showing on this matter.

I further find that the IRS cannot assert a good faith defense pursuant to 11 U.S.C. Section 548(c) based upon the finding of this Court that the IRS, as transferee, did not give value to the debtor in exchange for such transfer. Based upon all of the evidence, no benefit was given to Debtor as a result of the $26,823.22 transfer, all funds having been applied to non-debtor liabilities of either Mobley, individually, or non-debtor corporate liabilities of other entities. Accordingly, I conclude that the November 17, 1987 payment to the IRS is avoidable under 11 U.S.C. Section 548(a)(1) and (a)(2).

This conclusion does not, however, completely resolve this issue because the United States contends that, even if the transaction is voidable under section 548, it can not be held liable for the transfer under section 550 of the Bankruptcy Code. This argument is without merit because the Trustee is proceeding under 11 U.S.C. Section 502(d), which provides that "the court shall disallow any claim of any entity from which property is recoverable under section . . . 550 . . . or that is a transferee of a transfer avoidable under section . . . 548 . . ." 11 U.S.C. § 502(d). Thus, even if the United States were correct in its assertion that it is not liable under section 550, section 502(d) nevertheless dictates that its claim, at least to the extent of the avoidable transfer, be disallowed because it is clearly the transferee of a transfer which is avoidable under section 548. *See e.g.*, In re Octagon

Roofing, 156 B.R. at 219.

Moreover, even assuming that section 550 were applicable to this action, this section does not shield the United States from liability. Section 550 governs the liability of a party who holds property that was transferred to it as part of a transaction which is voidable under certain provisions of the Code, including section 548. In relevant part, it provides:

> (a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section . . .548, . . . of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from--
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> (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or
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> (2) any immediate or mediate transferee of such initial transferee.
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> (b) The trustee may not recover under section (a)(2) of this section from-
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> (1) a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided . . .

11 U.S.C. § 550. Thus, subsection (a) of section 550 sets forth the basic rule that the trustee may recover from either the initial transferee (i.e., the party that takes directly from the

debtor), or any immediate or mediate transferee (i.e., a party who takes from the initial transferee). Subsection (b), however, creates an exception for immediate or mediate transferees only, so that when such a transferee takes the property for value, in good faith, and without knowledge of the voidability of the transfer, the trustee is precluded from recovering from the transferee,[1] even if the value is not given to the debtor.

Thus, the threshold question in this case is who, between Mobley and the IRS, is the "initial transferee." If the IRS is found to be the initial transferee, then the safe harbor of section 550(b)(1) is not available to it. If, on the other hand, Mobley was the initial transferee, then the IRS would be an immediate transferee eligible for protection under section 550(b)(1).

Citing In re Auto-Pak, Inc., 73 B.R. 52 (D.D.C. 1987), the United States contends that, when Mobley exchanged check number 3171 for the bank check, he became the initial transferee of the check from Debtor. Therefore, according to the United States, when the IRS took the bank check from Mobley, it was an immediate transferee entitled to protection under section 550(b)(1) because took for value, in good faith and without knowledge of the source of the check.

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[1] Section 550(b)(2) also creates an exception for any transferee that takes from a transferee that qualifies under section 550(b)(1), but this exception is not at issue in the present case.

In Auto-Pak, the owner of the two corporations, Auto-Pak, Inc., and Stern Chemical, Inc., had taken an Auto-Pak check payable to the IRS to a bank, and exchanged it for a cashier's check that was payable to the IRS in the same amount. The owner then wrote on the cashier's check "Re: **Stern Chemical 8309 Period**" and mailed it to the IRS. The IRS applied the funds from the check to certain tax debts of Stern Chemical. Soon thereafter, Auto-Pak filed a petition under Chapter 7, and the Trustee brought an action seeking to set aside the transfer of Auto-Pak funds to the IRS as a voidable transfer under section 548.

The district court first concluded that the IRS, was an immediate or mediate transferee under section 550(a)(2), rather than the "initial transferee" under section 550(a)(1). In re Auto-Pak, Inc., 73 B.R. at 54. In reaching this conclusion, the court reasoned that, in having the Auto-Pak check issued to him, exchanging it at the bank for a cashier's check, and then writing the name of his other company on the check, the owner "essentially took control of the funds underlying the cashier's check and negotiated them on behalf of Stern Chemical and to the benefit of the Internal Revenue Service. He thereby created at least one mediate transferee - himself or Stern Chemical - and insulated the IRS from the fraudulent conveyance." Id. The court then held that the IRS was shielded from liability as a mediate transferee under section 550(b)(1) because "[t]he service took for value (that is Stern Chemical's payroll tax debt), in good faith and without any knowledge of the voidability of the transfer." Id.

Auto-Pak is factually distinguishable from this case because the maker/remitter or both checks was the same - C.P. Brown. The funds were part of the proceeds from a loan, made by a C.P. Brown to the Debtor. No transfer occurred when the C.P. Brown check, payable to the IRS, was exchanged for a cashier's check showing C.P. Brown as remitter and the IRS as payee. All that occurred was that uncertified funds were certified, so that the payee would be assured that the check was honored on presentment.

Moreover, the Eleventh Circuit has held that, in determining whether a party exercised sufficient control over funds to be considered a "transferee" under section 550, "courts [should] step back and evaluate a transaction in its entirety to make sure that their conclusions are logical and equitable." In re Chase and Sanborn Corp., 848 F.2d 1196, 1199 (11th Cir. 1988). The Seventh Circuit has adopted a more specific benchmark for determining when a party is a "transferee":

> [W]e think the minimum requirement of status as a "transferee" is dominion over the money or other asset, the right to put the money to one's own purposes. When A gives a check to B as agent for C, then C is the "initial transferee"; the agent may be disregarded.

Bonded Financial Services v. European Amer. Bank, 838 F.2d 890, 893 (7th Cir. 1988).

Looking at this transaction as a whole, it is clear that Mobley was not a transferee as the term is used in section 550. Mobley held no legal interest in the check number 3171. He was not the payor, the payee, a holder in due course, or even a holder of the check, as these terms are defined in Georgia's Commercial Code. *See* O.C.G.A. §§11-1-201(20), 11-3-302, 11-3-401. Although the check was the property of a corporation which Mobley owned, Mobley had absolutely no personal interest in the check and no legal right to put the proceeds from the check to his personal use. Nor did he take "dominion" over it as the corporate officer in Auto-Pak did. He held the check only as an agent of the Debtor. Accordingly, no "transfer" occurred until the check was presented for payment. It was at that instant that debtor's property, the proceeds of the loan from Brown, were debited from Brown's account and credited directly to the IRS. The funds were never in the hands of any transferee other than the IRS, and the IRS is thus the initial transferee of the funds.

The initial transferee has no protection under Section 550(a)(1) but is held strictly liable to the estate if it receives debtor's property and fails to give credit to the debtor. This is as it should be. A subsequent (immediate or mediate) transferee has had no face-to-face dealings with debtor and rightfully is protected if acting in good faith so long as value is given to its non-debtor transferor. The clearest example is a collecting bank or a subsequent purchaser of real estate. So long as it gives value to its transferor and is unaware of any fraud in the earlier transaction it should be and is protected by

Section 550(b). The initial transferee, dealing directly with the debtor, however, is strictly liable unless it gives value, not to any entity, but to the debtor. Here, the IRS was such an initial transferee, and is therefore strictly accountable under Section 550(a)(1).

Subordination of Tax Penalties

The Trustee also contends that the penalties shown on the IRS' proof of claim, whether listed as "secured" or not, are subordinated to a fourth priority pursuant to 11 U.S.C. Section 726(a)(4). Based upon the representations of the Trustee at the hearing, it appears that there will not be sufficient funds to pay general unsecured creditors in full, and accordingly, any allowed amount for penalties will not, in all likelihood, participate in a dividend from the estate. The IRS contends that the amount shown as a "secured" penalty, at the minimum, should be entitled to secured status and paid in full. The Court disagrees with this contention and sustains the Trustee's objection with regard to the subordination of the IRS penalties to fourth priority. The wording of 11 U.S.C. Section 726(a)(4) (fourth priority) is clear:

> (a) Except as provided in section 510 of this title, property of the estate shall be distributed--
>
> (4) fourth, in payment of any allowed claim, whether secured or unsecured, for any . . . penalty . . . arising before the earlier of the order for relief or the appointment of a trustee, to the extent that such . . . penalty . . . [is] not compensation for such pecuniary loss suffered by the holder of such claim.

11 U.S.C. §726(a)(4) (emphasis added).

Penalties, whether secured or unsecured, are subordinated in a Chapter 7 case pursuant to this provision. Accordingly, the amount of the penalties which this Court subsequently allows, whether secured or not, is subordinated pursuant to 11 U.S.C. Section 726(a)(4).

Other Tax Credits Due

The Trustee tendered into evidence, without objection, Exhibits "C-7" and "C-8", which are copies of IRS generated tax overpayment notices. Exhibit "C-7", for the Form 941 payroll taxes for the period ending September 30, 1981, showed an overpayment from the previous quarter (2nd quarter 1981) of $125.97. Exhibit "C-8", reflecting an overpayment for the Form 941 taxes for the fourth quarter of 1981, showed an overpayment of $1,950.86. Mr. Sams testified that the $1,950.86 overpayment for the fourth quarter 1981 was subsequently applied to the fourth quarter 1981 employment tax account of Savannah Fast Freight, Inc. This Court finds that the IRS has not satisfied its burden to explain why these overpayments were reversed and the funds reapplied to non-debtor accounts. Accordingly, the Debtor's second, third and fourth quarter 1981 Form 941 payroll taxes are to be considered paid in full, based upon the evidence presented by the Trustee and not rebutted by the IRS. The $71.99 overpayment shown on Exhibit "C-

7" was not addressed at the hearing, and the Court, therefore, concludes that the estate should not be entitled to an additional set-off of $71.99.

As further support for the contention by the Trustee that the Debtor had paid the second quarter 1981 and fourth quarter 1981 payroll taxes in full, as reflected on Exhibits "C-7" and "C-8", the Court notes that Exhibit "C-2", prepared by the Debtor on September 16, 1987, does not attempt to apply any payment to those quarters. Additionally, Exhibits "C-1", prepared by a tax technician for the IRS, likewise shows a zero "tax" obligation for the second and fourth quarters of 1981, although some interest and penalties are noted thereon. Since this Court has concluded that the Trustee's objections with regard to the second and fourth quarter 1981 tax payments are sustainable, interest and penalties related to said quarters will likewise be eliminated in the Court's analysis of the allowed amount of the IRS claim.

Overstated Interest and Penalties

The Trustee further contends that by virtue of the failure of the IRS to give credit against its claim for the Brown cashier's check proceeds, and the other credits above-stated, the amount of the IRS proof of claim is overstated as to interest and penalties which accrued on the inflated balances. Since the Court has concluded that certain credits are due the estate, an adjustment of interest and penalties is appropriate. Other than the allocation made by the IRS for penalties and interest shown on the "secured" portion of

the IRS' proof of claim, the remaining penalties listed, in the amount of $13,077.48, are not itemized on the proof of claim and the Court, therefore, cannot precisely allocate the penalties to specific quarterly payroll tax obligations. However, the Court can utilize Exhibit "C-1" as a guide in estimating what those penalties were or should have been, since the IRS letter identified as Exhibit "C-1" was dated May 12, 1987, which is within a few months of the petition date.

For the second quarter 1981, Exhibit "C-1" shows no penalty. For the fourth quarter 1981, Exhibit "C-1" shows a penalty of $1,626.69. The Court finds that the penalties on the IRS' proof of claim should be reduced by the amount of $1,626.69, which is related to the fourth quarter 1981 payroll tax obligation of the Debtor, since Exhibit "C-8" shows the tax was overpaid as of the time Exhibit "C-8" was prepared by the IRS. Because the penalties allowed are otherwise subordinated pursuant to 11 U.S.C. Section 726(a)(4) and in all likelihood will not be paid, any further attempt to allocate penalties will serve no useful purpose.

Because the Court has concluded that the second quarter 1981 and the fourth quarter 1981 taxes were overpaid by the Debtor and that the IRS was not justified in shifting those payments, the Court also finds that any amounts listed on the IRS' proof of claim as interest or principal for the second and fourth quarters of 1981 must be eliminated. Accordingly, interest shown for the second quarter 1981 ($2,183.72), as well

as principal ($1,608.10) and interest ($1,893.13) for the fourth quarter 1981, are to be eliminated from the allowed amount of the IRS' claim.

Because I have concluded that the Brown cashier's check proceeds, in the amount of $26,823.22, should have been applied by the IRS to the respective tax liabilities indicated on Exhibit "C-2", the secured portion of the IRS' proof of claim shall be reduced by $7,053.26 (first quarter 1983 tax liability), and the Section 507(a)(7) priority portion of its claim shall be reduced by $19,766.20 (for the second, third and fourth quarters of 1983, for the first and fourth quarters of 1984 and for the FUTA tax for 1985), and the general unsecured portion of its claim shall be reduced by the amount of $3.76 (for the 1983 FUTA tax). The 1983 FUTA tax is a general unsecured claim, without priority, since it was more than three years past due at the time of the filing of the Chapter 7 involuntary petition, and, therefore, is not entitled to priority pursuant to 11 U.S.C. Section 507(a)(7)(D).

The only remaining argument of the Trustee, with regard to overpayment of interest and penalties, concerns the effect thereon of a timely credit by the IRS of the Brown cashier's check proceeds when received on November 17, 1987. However, since the Debtor's petition was filed on December 2, 1987, only fifteen days after the IRS received the payment, and based upon the statements of the Trustee at the hearing, it would appear that any attempt to recalculate the interest and penalties for this brief period

of time would not be in the interest of judicial economy. The Court will, therefore, not attempt such recalculation under the principal of *de minimus non curat lex.*

Application of the One Hundred Percent Penalty Payment

The Trustee lastly contends that the seizure by the IRS of the personal income tax refund due Elton and Virginia Mobley in the amount of $3,818.00, and application thereof to their assessed one hundred percent penalty, as former corporate officers of Debtor (Exhibit "C-9"), should be allowed as an off-set against the Debtor's withholding tax obligations for the first quarter 1984 in a like amount. However, as previously stated above, the one hundred percent penalty is technically an independent liability of the responsible officer pursuant to 26 U.S.C. Section 6672(a). Although the IRS customarily collects the full tax only once, either from the employer or the responsible person, nothing in the text of Section 6672(a) prevents the Commissioner of Internal Revenue from collecting both the taxes withheld from the employer and the penalty from the responsible person. *See e.g.*, Levit v. Ingersoll Rand Financial Corp. (In re Deprizo Construction Co.), 874 F.2d 1186, 1191 (7th Cir. 1989). Since the tax refund seized by the IRS was the individual property of Elton and Virginia Mobley, and not the Debtor, I decline to hold that the estate is entitled to credit for this personal refund so applied by the IRS.

Conclusion

The proof of claim of the IRS can be broken down into its four respective components, namely, Secured, Section 507(a)(7) priority, General Unsecured and Section 726(a)(4) penalties, as follows:

TAX/PERIOD	SECURED	PRIORITY §507(a)(7)	GENERAL UNSECURED	PENALTIES §726(A)(4)	TOTALS
1-Q/83 (941)	(p) $7,053.26 (i) $6,335.77			$3,213.96	
2-Q/81 (941)		(i) $2,183.72			
4-Q/81 (941)		(p) $1,608.10 (i) $1,893.13			
2-Q/83 (941)		(p) $7,397.85 (i) $6,753.46			
3-Q/83 (941)		(p) $3,460.54 (i) $6,028.18			
4-Q/83 (941)		(p) $996.84 (i) $3,334.15			
1-Q/84 (941)		(p) $7,600.44 (i) $4,588.42			
4-Q/84 (941)		(p) $115.00 (i) $232.35			
1-Q/85 (941)		(i) $104.50			
1983 FUTA (940)			(p) $153.36 (i) $94.13		
1985 FUTA (940)		(p) $109.20 (i) $20.83			
Other Grouped Penalties				$13,077.48	

Totals per P/C #17	$13,389.03	$46,426.71	$247.49	$16,291.44	$76,354.67

Based on the foregoing, said proof of claim is to be reduced by the amount of the Brown cashier's check ($26,823.22) for the respective taxes as shown on Exhibit "C-2." Additionally, the IRS proof of claim must be reduced by the amount of any second quarter 1981 and fourth quarter 1981 payroll tax obligations shown thereon, the same having been found to have been paid in accordance with Exhibits "C-7" and "C-8" (*See* Exhibits "C-1" for the $1,626.69 penalty allocated for the fourth quarter 1981 tax obligation). Further, the overpayment of $1,950.86 shown on Exhibit "C-8" must be deducted from the amount of the IRS priority claim, since this amount was applied by the IRS to non-debtor liabilities without authority.

O R D E R

Pursuant to the foregoing Findings of Fact and Conclusions of Law, IT IS THE ORDER OF THIS COURT that Claim number 17 of the Internal Revenue Service is allowed in the reduced amount of $40,268.95, with the respective priorities indicated below:

TAX/PERIOD	SECURED	PRIORITY §507(a)(7)	GENERAL UNSECURED	PENALTIES §726(A)(4)	TOTALS
Totals for Proof of Claim #17	$13,389.03	$46,426.71	$247.49	$16,291.44	$76,354.67
Cashier's Check Applied per Exhibit C-2	<7,053.26>	<19,766.20>	<3.76>		<26,823.22>
2nd Qtr./'81 Overpaid per IRS Notice Exhibit C-7		<2,183.72>			<2,183.72>
4th Qtr./'81 Overpaid per IRS Notice Exhibits C-8 and C-1		<1,608.10> <1,893.13>		<1,626.69>	<5,127.92>
Overpayment shown on Exb. C-8 Misapplied to Non-Debtor Accounts		<1,950.86>			<1,950.86>
Allowed Claim of IRS	$6,335.77	$19,024.70	$243.73	$14,664.75	**$40,628.95**

Lamar W. Davis, Jr.
United States Bankruptcy Judge

Dated at Savannah, Georgia

This ___ day of June, 1994.